

4. PRICES, WAGES AND EMPLOYMENT

Inflation began to moderate since March 2005 reversing the rising trend that commenced during the second quarter of 2004 with the improvement in supply conditions and continued containment of the demand pressures through monetary policy. A further moderation of inflation is expected in 2006. Real wages in the public sector increased, while real wages in the formal private sector covered by the Minimum Wages Boards and daily real wages in the informal private sector declined. The labour force is projected to increase by 1.1 per cent to 8.2 million in 2005. The unemployment rate hovers around 8-9 per cent.

Prices and Inflation

- **Inflation began to moderate since March 2005.** This pattern was observed on all available Consumer Price Indices (CPIs) with the improvement in supply conditions. The rising trend in inflation rates signaled by the point to point increases, which had risen from early 2004 until the first quarter of the year reflected a slow down in intensity towards the second half of the year. The inflation measured as point to point increase stood at 10.5 per cent in September 2005.
- **Price increases of both imported goods and domestically produced goods contributed to overall inflation during the first half of the year.** The average expenditure on domestically produced consumer

goods, which represents around 78 per cent in the CCPI, increased by 10 - 14 per cent during the first half of 2005, compared to the same period of 2004. The rising prices of imported consumer goods, which represent the balance share in the CCPI, raised the expenditure on imported consumer goods by 5 - 8 per cent. However, imported intermediate goods, especially crude oil, imposed a significant indirect pressure on consumer prices. In addition, higher monetary expansion also contributed to raise demand driven inflationary pressures.

- **International oil prices increased significantly both in 2004 and 2005, resulting in an increase of the associated costs.** However, the increase in domestic fuel prices was not in line with rising international

Chart 4.1
Trends in Price Indices (Percentage Change)

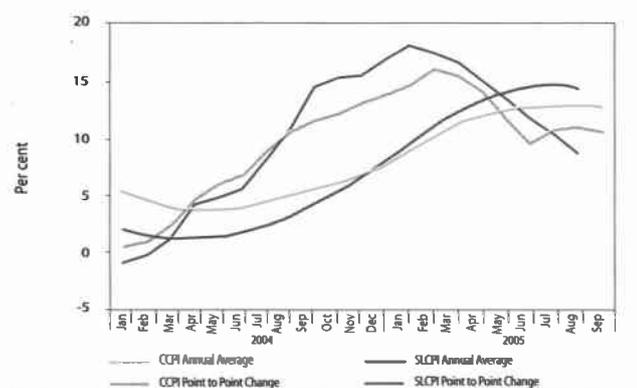
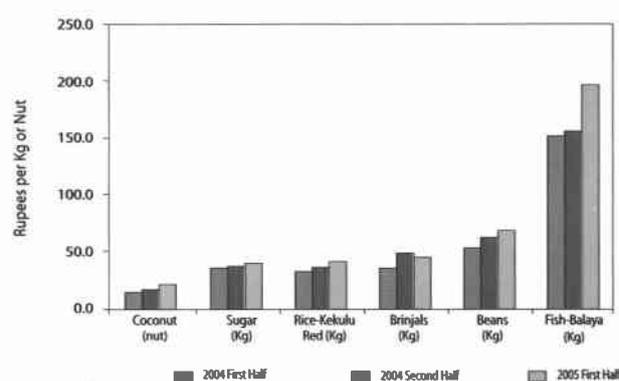


Chart 4.2
Domestic Prices of Key Food Items



prices. The removal of the VAT on key imported items, namely, diesel, L.P. gas and milk powder was also beneficial in dampening the impact of rising imported costs on consumer prices.

- **Domestic and external developments are expected to be favourable and help reduce inflation pressure during the second half of the year.** Accordingly, the annual average inflation would lie in a range of 10 to 11 per cent at the end of the year, as per the CCPI and SLCPI.

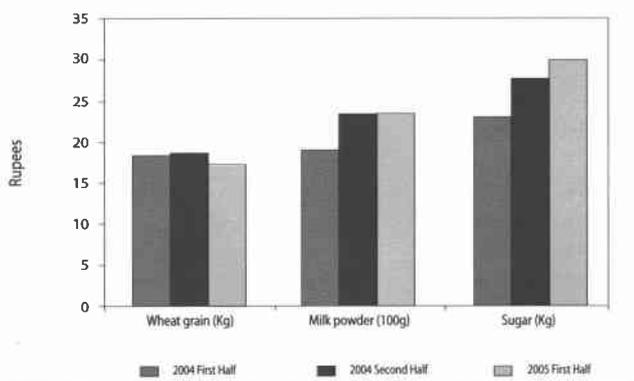
Wages

- **Employees in the public sector enjoyed increased real wages, while some of those in the private sector suffered from falling real wages.** The public sector wages, as reflected in the wage rate indices for non-executive officers and school teachers in the public sector, were significantly higher in real terms consequent to the salary revisions for the sector in December 2004.
- **The Ministry of Labour Relations and Foreign Employment (MLRFE) proposed a private sector**

salary increase in parallel to the increase in public sector salaries in the Budget 2005. An increase of Rs.1,000 per month was approved by the Cabinet in July 2005. The Apparel sector, however, was exempted for a 6 month period ending January 2006, in implementing this proposal, due to anticipated problems that had to be faced in that sector with the cancellation of the Multi Fibre Agreement (MFA). Many employers, however, are of the view that salary increases have to be related to productivity and should not interfere with the operational management of their organisations.

- **All plantations under 22 management companies, which have entered into collective agreements, were excluded from this wage proposal.** In terms of the Industrial Disputes Act (IDA), the Minister of Labour Relations and Foreign Employment extended the collective agreements in the plantation sector to the plantations covered by the wage boards of the Tea Growing and Manufacturing Trade and Rubber Growing and Manufacturing Trade as well. Although the plantation companies with these new collective agreements were excluded from the proposed wage increase, their employees were more than compensated by the increase in their daily salaries from Rs.135 to Rs.200 under the collective agreements.

Chart 4.3
Import Prices of Major Food Items



Employment

- **The labour force is estimated to increase by 1.1 per cent in 2005 to 8.2 mn.** Labour force participation rate is also estimated to rise marginally to 48.9 from 48.6 per cent in 2004.

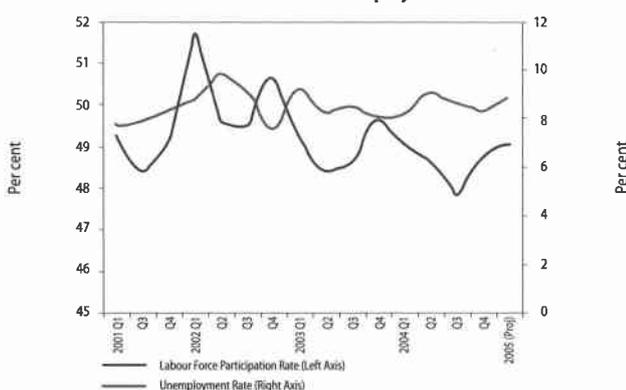
- **In addition to the irreplaceable human resources lost to the labour force, it is estimated that about 150,000 persons (2 per cent of the labour force) lost their livelihoods in the fourth quarter of 2004** on the basis of a Census of tsunami affected areas conducted by the DCS and the findings of Consumer Finances and Socio Economic Survey conducted by the Central Bank in 2003/04.
- **The unemployment is projected at around 8.5 to 9.0 per cent in 2005.** However, any unemployment caused by the tsunami is expected to recover gradually during 2005. The healthy growth in the Agriculture sector, especially in paddy production in 2005 will also have a benefiting effect on employment generation. The government also introduced a number of loan schemes to revive small and medium enterprises. Under the Susahana loan scheme, around Rs. 3.2 billion of a Rs. 5 billion fund has been disbursed to 6,986 recipients through banks and financial institutions up to end September 2005.
- **The graduate employment programme, which was implemented in the fourth quarter of 2004, was**

intended to fill 20,000 existing vacancies and another 22,000 newly created vacancies in the public sector. Under this programme, the government recruited 42,000 graduates as trainees on a monthly allowance of Rs. 6,000, and was expected to make their postings permanent in the government as well as in the semi government institutions by May 2005. However, the government has confirmed employment for around 22,000 trainees up to mid-September 2005 and others are to be given permanent employment soon.

- **According to the Sri Lanka Bureau of Foreign Employment (SLBFE), the forecast for foreign employment departures in 2005 stood at around 221,000, an increase of around 8,000 compared to 2004.** The registered number of departures for foreign employment in the first half of 2005 grew marginally by 1 per cent to 101,417 compared to 9 per cent growth in the first half of 2004.
- **Housemaids continued to record the highest share of migrant workers.** Together with the increase in the share of housemaids among manpower categories, the relative share of males in the total departures for foreign employment also continued to rise gradually. The share of males, which was 25 per cent in the mid-1990s increased to 38 per cent in the first half of 2005. The increase in the share of males in total foreign employment departures in 2005 was mainly due to demand created for male oriented jobs in Doha and Qatar.
- **There are more opportunities for skilled migrant workers.** For Sri Lanka to be competitive in the

Chart 4.4

Trends in Labour Force and Unemployment 2001-2005



skilled worker category, the Tertiary and Vocational Education Commission (TVEC) has initiated a special project with donor funding to re-organise and develop the tertiary education system from 2004, in addition to the programmes which are already in place.

- **The MLRFE gazetted the new compensation formula on 15 May 2005 under the Termination of Employment of Workmen (1971) (TEWA) amendments** after reviewing it in the National Labour Advisory Council (NLAC). The NLAC comprises the MLRFE, trade unions and representatives from employers. At the current high rates of compensation, the demand for termination of workers has been low, with only 7 compensation awards under the new formula involving about 250 workers as at 31 July 2005.
- **The compensation seems too costly according to Employers' Federation of Ceylon (EFC).** The new compensation formula pays the highest compensation in Asia for retrenched workers and most of the companies who opted for restructuring have found that the implementation is too costly under the new compensation formula.
- **Efforts are being made to establish a safety net (Unemployment Benefit Insurance Scheme (UBIS))** to provide income support, and other benefits that promote employability of displaced workers.
- **The MLRFE initiated the Shop and Office Act amendments to repeal the restrictions on night**

work for females attached to the IT sector. These amendments are expected to maximise benefits from the incentives available in the software industry and IT enabled services industry. The bill containing the amendments will be presented to the Cabinet of Ministers for approval and then to the Parliament in the near future.

Prospects for 2006

- **Inflation is expected to moderate in 2006.** Expected developments on both domestic and external factors are expected to contribute to this outcome. A favourable year is expected for the agriculture sector with benign weather conditions. The consequent expansion in production with improved distribution systems are expected to have a favourable impact on prices.
- **The international prices of some major consumer imports such as wheat grain, sugar and rice, are expected to fall during the year due to expected expansion in world production.** However, contrary to the earlier expectations, world oil prices have indicated that the upward trend will continue.
- **The unemployment rate is projected at around 7.5 to 8.0 per cent in 2006** mainly due to the expectation that the Agriculture sector will continue to expand as in 2005 with the favorable weather conditions. The revival of the Tourism and Fishing sectors would also help to generate more employment activities, thereby leading to a lower unemployment rate in 2006.